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ABSTRACT

Three big-city school systems nearly went bankrupt in the 1970s. New York City, including its schools, ran out of money; Cleveland closed its schools for long periods to conserve funds; and Chicago's schools ran out of credit. This paper narrates these crises, examines the responses of state governments and teacher and custodian unions, and looks for causes and possible solutions. While specific causes varied from city to city, in all three instances the city school boards had great difficulty both in closing underutilized schools and in raising property taxes and all three attempted to cover budget deficits with short-term borrowing. In response, the state in each instance took over major budget, financial, and sometimes labor decisions from the city school board and imposed large cutbacks that the board, the unions, and local neighborhoods had to accept. City school systems with similar potential problems may avoid such crises through effective and timely retrenchment, in which closed school buildings are used by other agencies and school employees' fears are taken into account, and through increased state funding on an emergency, as-needed basis, a response pioneered in Ohio. (Author/RW)

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BIG CITY SCHOOL BANKRUPTCY

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Abstract

Urban centers, long-time leaders in educational innovation and opportunity, by the 1960's were faced with severe social and financial difficulties, including declining enrollment, racial discord, and labor unrest.

During the 1970's several large urban educational systems faced the prospect of bankruptcy and default; the solutions included imposition of severe fiscal controls and adoption of drastic retrenchment measures. Problems facing three of these cities, and measures taken to deal with them are carefully examined in this paper--New York, where the municipality ran out of credit; Chicago, whose schools ran out of credit; and Cleveland, which closed schools down for weeks at a time to live within financial constraints.

While fundamental differences exist in each case, the similarities should be paid particular attention, for the basic issues are applicable to the educational system in its entirety. Specifically, what are the underlying causes for fiscal crises, what are the responses of governments (local, state, and federal), the lending community, teachers and administrators, and the public? What are the effects of the proposed solutions on the structure of school systems, will they lose autonomy as financial control boards are set up to monitor budgeting processes, and what safeguards must exist against recurrence of such crises in the future?

INTRODUCTION

Ambitious teachers the first half of this century tried to plan their careers so they could move from small towns to one of the higher paying big city school districts. The best of the rural school superintendents climbed a career ladder of increasingly larger superintendencies so that they might reach the pinnacle of a big city school district executive position.

Why not? Most cities from 1900 to 1950 had the advantages of substantial industrial wealth, an above average property tax base, and teachers of above average commitment and professional training. Cities led the way in the establishment of free kindergartens, vocational schools, programs for the handicapped, and of senior high schools with advanced or specialized programs. City schools offered visible, exciting, usually well-financed career opportunities.

During the 1960's cities became a more difficult place in which to teach or administer schools. Industry gradually withdrew to the suburbs or to the south. The housing stock decayed faster than new urban projects could be build. Transit workers, sanitation workers and even teachers and hospital interns went out on strike. Middle class families and blue collar families left the city. City schools, with some exceptions, lost their financial edge and their reputations for academic excellence.

This paper examines an advanced stage of urban pathology, the point at which cities or at least city school systems learn that they cannot borrow any more money on their own good name. City schools, usually proud of their independence from the usual political and economic structures find their traditional autonomy challenged. More bluntly, the state and the banks or both tell school officials to file reduced budgets as a condition by which to obtain financial relief at a time of crisis. How did this come to pass?

1. THE CAUSES AND THREE CASES

Several major city school systems, New York, Chicago and Cleveland, teetered on the edge of default and bankruptcy between 1975 and 1980. Why did this happen? How did government (local, state, Federal) respond? What are the benefits and costs of such solutions as financial control boards and state school fund advances? What policy questions emerge from these experiences.

The common theme is one of trauma, of the breakdown of services to children which society has decreed to be essential to the state. It must be noted early that each of the cases have fundamental differences, e.g.

1. In New York the entire city ran out of credit and the schools were totally dependent on whatever funds the city could borrow on their behalf.

2. In Chicago the schools lost their credit rating despite a substantial borrowing capacity separate from that of the city.

3. In Cleveland the Ohio state laws so sharply restricted borrowing that cities prior to 1980 closed down for weeks at a time to "save" money to meet financial commitments. Cleveland in 1978 would have closed except for a federal court order to keep the schools open.

At the same time each of these cities has a history of labor conflict, racial discord, and substantial enrollment decline. The solutions to the financial crisis in each case required the imposition of severe fiscal controls and adoption of drastic retrenchment measures. Several states imposed upon the city some kind of watchdog board and a borrowing capacity separate from that of the City Board of Education. This is new ground in the history of public school finance. Not since the depression have the states developed complicated bankruptcy, receivership, or extraordinary borrowing mechanisms for local school systems.

However, scattered examples or precedents can be found. Periodically the New York Commissioner of Education has appointed a special administrator or monitor to oversee financially troubled schools. The most recent cases were Lackawanna and then Roosevelt, a Long Island school district, in 1977. The state-designated administrator remained in place just long enough to restore financial stability and the cooperation of lenders in reviving the health of the school district. The New Jersey Commissioner of Education also can and has appointed special administrators to restore financial stability to poorly managed school districts.

2. NEW YORK, CLEVELAND AND CHICAGO

New York City announced the prospect of bankruptcy when the Mayor informed the Governor on April 7th, 1975 that $400 million in short term city notes could not be paid on April 15th. The city could not market any additional tax anticipation bonds, the usual method of solving cash flow crises and rollings over accumulated debt. City payrolls had to be met and other bills paid. The state was asked to advance payments to the city and otherwise help Mayor Abraham Beame cope with the crisis.

How could this happen in such a strong and important financial center?

One explanation is that of a New York City Deputy Mayor Jim Cavanaugh whose favorite maxim was "It is better to borrow than to raise taxes." As long as banks were willing to lend money to a city, this strategy worked. The day of reckoning could be postponed. Municipal tax exempt bonds have long been regarded as reasonably good risks since so few public bodies went bankrupt 1940 to 1975.

New York City was also the victim of the 1974-75 recession and dip in city sales tax revenues. Mayor John Lindsay's first seven budgets were technically balanced. His eighth and last was not, nor were Mayor Beame's first two budgets. Also, fiscal gimmicks included the use of long term debt to finance current teaching for vocational education expense items, such as the paying of salaries to teachers.

Another explanation is that of Peter Goldmark who was Governor Hugh Carey's Budget Director in 1975 and coordinated the initial state responses. Goldmark suggests that New York City in particular had assumed unusually heavy responsibilities for human services - far beyond the statutory requirements of either the state and federal government or the capacity of any level of government to pay for them. For example, New York City public higher education in the 1970's carried out an "open admissions" policy which meant that any student could attend the City University free even if substantial remedial work was required prior to qualifying for a degree. Health, Education and Welfare programs were not only extensive and expensive but beyond the ability of the city to pay for them. Goldmark calls this phenomenon "social overload."

New York City schools were totally dependent on the city for whatever borrowing was needed. Two thirds of the school operating costs for New York schools came from city taxes. When the city went broke, so did the schools.

Of course the school system contributed to the total cost of city services. Furthermore, although New York City schools enrollment declined by 50,000 pupils (from 1,146,460 in 1971 to 1,099,004 in 1975), very few school buildings were closed nor was staff reduced in size.

Cleveland schools are fiscally independent of the city and have separate access to the property tax base. The Cleveland Board of Education is an elective body with its own borrowing capacity. Periodically the Cleveland Board of Education took to the voters the question of raising the tax levy needed to pay for the schools. The electorate in the 1960's responded favorably. During the 1970's on several occasions the city ran short of funds to meet current obligations. Union settlements required more funds than were available. Ohio law is strict and requires that school districts live within the income generated by revenue that same year. Long term or multi-year debt is allowed only for capital construction projects, not for operating costs.

One remedy that was used by various local city school boards in Ohio prior to 1979 was the closing of schools for several weeks during the year until enough money was "saved" and cash accumulated to pay the staff and operate the schools. This practice also alerted the parents and taxpayers that the Board of Education really couldn't run the schools without either more local or more state support. However, during the 1970's more than one Ohio City carried out the threat of periodic middle-ofthe-year closings and could not convince the local taxpayers or the state to "bail them out."

Furthermore, Cleveland along with six other Ohio city school districts faced the prospect of court-ordered desegregation. Voters unhappy with "busing" expressed their disapproval with the implementation of a courtimposed desegregation plan by voting "no" on tax levies as Cleveland voters did twice in

1978 alone. Desegregation plans cannot be permanently delayed for reasons of insolvency but opponents generally act as though bankruptcy may work as an excuse for keeping neighborhood schools and remaining racially segregated.

Cleveland also lost enrollment in the 1970's from a high of 153,000 in 1968 to 90,000 in 1979. During that time the Board debated closing down from 15-36 schools but kept postponing the decision and actually increased the teaching staff by several hundred.

The Chicago Mayor appoints the Chicago Board of Education and the elected City Treasurer acts as the school treasurer as well. Otherwise, Chicago schools, like Cleveland, are fiscally independent of the city, can legally ask for a tax increase through a referendum, and can borrow money on its own authority. Hundreds of Illinois school districts must and legally may borrow each year up to 85% of the anticipated property tax yield because these taxes traditionally are collected late in the year.

Most Illinois districts issue tax anticipation warrants that are paid back just as soon as the property taxes flow into the school treasury. Chicago schools, however, issued tax anticipation notes valid for a period of one or two years for as long as a bank was willing to arrange for the money to be raised.

Chicago schools' enrollment in the 1970's dropped from a high of 573,000 students in 1971 to 477,000 in 1979. Although hundreds of temporary classroom units were removed from school yards, hardly any buildings were closed. Everytime the General Superintendent proposed closing a building, a delegation of parents, often led by an alderman or helped by school employees, would storm the Board of Education and cause such a furor that the proposed closing would be shelved. The cost per pupil rises in half-empty schools with a full complement of custodians who in Chicago are assigned to schools by a formula based on the square footage of the building.

Chicago also faced desegregation challenges both from the federal government and the State Board of Education. HEW in 1978 negotiated a faculty desegregation and a costly bilingual student program agreement with the Chicago Board. Federal officials, however, could not assign much in the way of new funds because of an unacceptable student desegregation plan.

The Illinois Board of Education in 1976 placed Chicago schools on probationary status which was a warning that state funds could be cut if a satisfactory student desegregation plan was forthcoming. Chicago school officials prepared "Access to Excellence", designed to be both an education plan and an initial desegregation plan relying largely on voluntary measures. General Superintendent Joseph Hannon estimated a cost of from $24 to 50 million a year for "Access". This plan, which moved the equivalent of 30,000 students, satisfied neither state officals nor in 1979 HEW which also demanded a comprehensive student desegregation plan. "Access" staffing also contributed to the continued employment of approximately 25,000 teachers while enrollment dropped by thousands of students each year.

Chicago Board members and staff publicly complained about federal and state laws which mandated a high level of service, e.g., to handicapped students, without commensurate funds or immediate reimbursement. However, Chicago continued to budget funds for a separate Board of Education radio station, a teacher certification office separate from that of the state, and a central office supervisory and technical staff of more than 3,000 employees.

Another factor was the replacement of the Corporate Personal Property Tax by action of the 1970 Illinois Constitutional Convention. This tax was to be replaced by substitute taxes approved by the Illinois Governor and General Assembly by 1979, a package on which no agreement was reached until August of that year. Meanwhile the payment and actual collection of this unpopular business tax in Cook County and Chicago worsened each year, falling to 40% of estimated yield by 1978 and causing an additional shortfall of twenty to thirty million dollars to Chicago schools each year.

One solution to the Chicago school fiscal problem was to raise property taxes. Mayor Richard Daley after 1971, however, would not agree to an increase in taxes, preferring to try to pursue state and federal sources. He and his successors were by many criteria quite successful. Chicago schools in fact drew 58% of the 1979-80 budget from state and federal sources -- a higher percentage than most of the big cities in the nation and approximately twice the percentage New York City schools received from state sources. But local tax rates were not raised during the balance of the 1970's and the delay of the corporate replacement tax by the legislature aggravated the Chicago school revenue and cash flow position.

An unacceptable solution was to cut days from the school year to save money. Illinois law not only required 176 days of instruction but authorized the state superintendent to levy a penalty of up to 1% of state aid for any days missed. When in 1976 the Chicago Board cut 16 days the state in fact deducted $30 million in state aid, an action subsequently upheld in the Illinois Supreme Court.

The other solution was to borrow more money and roll over a portion of the debt into future months and years. Don Haider, for a while Mayor Jane Byrne's budget director, compared this to a "kiting" scheme in which a person covered last month's loan and interest payments this month with a new and larger loan. Sooner or later the bubble had to break. That moment for Chicago schools came in November 1979 when the banks asked for more disclosure of information on "inter-fund" borrowing practices. Illinois law establishes separate funds for education, transportation, building maintenance, debt service and other categories. Moody's bond rating service lowered the municipal investment grade of Chicago school bonds because sinking fund money to repay notes had been used to meet payrolls, in effect recycling old debts into new debts. This action by the rating service made the Chicago school system credit-bankrupt, unable to pay off old notes and still meet payrolls and other obligations.

3. THE STATE RESPONSE AND FISCAL RESTRAINTS

New York State officials responded very quickly to the plight of New York. Fortunately for the city, the state was able to expedite the flow of four hundred million dollars to meet current obligations of the city. No paydays

were missed. No payments to bondholders were missed, although some of the notes were "recomposed", a device that unilaterally extended the duration of the indebtedness and added interest to those holding the paper. By the time a court invalidated this procedure other mechanisms were in place and the crisis averted.

City and state officials agreed on the need for a new entity to gain access to credit for New York City. The New York legislature was asked in the Spring of 1975 to create the Municipal Assistance Corporation, an eleven member board with the power to borrow money for New York City. State officials also wanted this group to possess the authority to impose budget limits and force the curtailment of municipal spending. Mayor Beame fought effectively against the latter proposal which he accurately saw would reduce dramatically his independence and that of the City Board of Estimates, which already had those responsibilities.

MAC issued several hundred million dollars in notes during the summer of 1975 but it became clear that investors would not gamble on a needed second round of purchases without evidence of a streamlined budget for the city. By September the Governor was able to insist on the legislative creation of an Emergency Financial Control Board with the power of budget review and approval.

Although four elected officials--the Governor, State Comptroller, Mayor and City Comptroller--were voting members, the Governor had the authority to name three other members and thus had majority control of the new board. The city paid the expenses of the Board and staff.

Also, the state assigned a Deputy State Comptroller for New York City, Sidney Schwartz, the fiscal watchdog duties of analyzing budgets and auditing the expenditure pattern. His reports on New York City spending were available to the Control Board. He and his staff had access to whatever data they deemed necessary. Although created by the state, the city paid for this function as well.

The Control Board also had the power to review, approve or reject all contracts of more than a million dollars including employee contracts. It so happened that the New York City teacher contract was up for renegotiation during the summer of 1975. Instead of having $45 million to distribute to teachers as was thought possible in early Spring, the Board negotiators during the summer were handed a new budget guideline that called for a $45 million reduction in total school expenditures.

All city agencies, boards and commissions were required in 1975, to submit plans for reduction of services and costs. It was not going to be possible to borrow all the funds needed to continue all existing commitments. Funds for 77 day care centers were eliminated. Free tuition at the City University was an eventual casualty. Nineteen fire companies were closed. The subway fare was increased by 40%. Library services were curtailed. Fourteen thousand education positions were abolished, which meant, after resignation and retirements were calculated, 7,000 teachers were issued termination notices. Sixty school buildings were closed. The city deficit was reduced by one billion dollars.

At the same time New York state and city officials sought a large loan from the U.S. government. Federal Treasury officials were strongly opposed to the concept as well as the possible precedent. They persuaded President Gerald Ford to say he disapproved of such a "bailout" loan and would veto any bill. The Secretary of the Treasury and staff advised Senate Banking Committee chairman William Proxmire not to recommend positive action on a loan or guarantee. Nevertheless, New York City officials prevailed with the argument that the bankruptcy of such a community was unacceptable. The Congress eventually agreed to an immediate direct loan of $2.4 billion for 1975-78 and access to the U.S. Treasury for an additional loan guarantee of $4 billion for 1978 to 1982, in effect establishing a line of credit to the city if needed. One of the conditions of federal assistance was the continuation of the Control Board for the duration of access to any Federal loans.

*Cleveland schools closed for periods from four to six weeks in the years 1978, 1979, and 1980 all because of teachers strikes. For a while the Ohio Board of Education adopted a hands-off attitude. It became involved, however, when a federal court ordered the state to participate in the development of a desegregation plan for the city. Also, a new state superintendent, Franklin Walter, took office and assumed a stronger advocacy role for state assistance to urban schools.

First, he proposed that the practice of closing down school districts for a month or so to save or accumulate money be outlawed. Instead, a school district could draw down an advance from the state through the mechanism of an Emergency Education Advance Bank. However, a school district would be required to develop a plan to balance the budget within eighteen month by retrenching staff and services and other measures. State Board of Education staff would review this plan before state advances would flow to the city school district.

Second, he proposed that the state provide technical assistance to school districts to help them economize and develop plans to close buildings. In effect, Ohio officials would be sent in to identify budgetary cuts in order to achieve a balance school budget.

The Governor and legislature approved state creation of an Emergency Fund and agreed to make available $40 million in 1979 and $10 million in 1980. These sums were sufficient to allow city schools to remain open. The law banning school district mid-term closings took effect in 1980. Ohio said in effect that districts had to continue to balance their budgets without resorting to the closing of school in order to accumulate cash.

Cleveland schools also went through the painful process of retrenchment and closed 30 schools and dropped nearly 2,000 employees in 1979 and 1980. Meanwhile, a federal judge insisted on a three year timetable for desegregation 1979-1981. Cleveland school officials requested and obtained a $20,000,000 advance in 1979.

When Chicago schools lost access to investors, all eyes turned to New York City. The Mayor hired New York City financial advisors in addition to special legal counsel. She asked Jerome Van Gorkom, President of the Trans

Union Corporation, to head up a committee to develop solutions. The Chicago Board of Education employed financial advisors over and above their auditors, Arthur Andersen and Company. The Governor soon turned to Lazard Freres, the New York City investment experts whose partners included Felix Rohatyn, the third and best known chairman of the Municipal Assistant Corporation. Gene Kaelin, a municipal bond analyst who also served on MAC, and Steve Burger, a former director of the New York City Control Board who also helped design a state stragegy, were assigned to help Illinois Governor James R. Thompson prepare strategies for solving the Chicago school crisis.

No one in Illinois paid much attention to the Ohio solutions. New York City is number one. Chicago styles itself "The Second City" and the talk in Chicago and Springfield was mainly of MAC and Control Board solutions.

On an interim basis the Governor, State Treasurer, State Comptroller, and State Superintendent of Education cooperated to speed up the payments of state education aid to Chicago to meet payrolls. December state aid payments were advanced to November; January aid came in December. The State Superintendent advanced federal and state payments for vocational-special education and transportation.

The Governor urged the Mayor to develop a city solution including the pledge of city credit to the city schools. Mayor Jane Byrne retorted that the 1970 Illinois Constitution declared the state to have the primary role in financing education. She said the city could not and should not bear the major responsibility. In fact, the city could not help very much since the city cash balances were at that time precarious, the city credit rating in jeopardy, and the city in need of additional fees or tax revenue.

The State Treasurer, Jerome Cosentino, announced his concern that the advance of state aid payments to school districts was depriving the state of interest earnings of 10% or more. He proposed the loan of state money to Chicago schools with provision for later repayment of principal and interest. He and the Mayor in fact publicly announced such a solution just prior to Christmas 1979, but the Governor objected, stating that his signature was needed to authorize such a transaction. The Governor called for agreement on a long range solution saying that loans or advances simply delayed action on developing an appropriate long-term solution to the problem. The city was unwilling and actually unable to advance or pledge any money, so the teachers on December 21st, practically, the eve of Christmas, went payless for the first time.

The first week in January Governor James Thompson convened a meeting at the Governor's mansion of thirty representatives of the Chicago Board of Education and the Chicago banking community, teacher union officials, state officials including the Governor's legal and budget advisors, the State Treasurer, and State Board of Education staff. The task was to develop short and long term solutions including such legislation as was needed to float notes for Chicago schools.

New York City advisors persuaded the Illinois Governor in his plan to combine the MAC and Control Board functions into one entity. They also urged that the Chicago Board, teacher leaders, mayor's representatives, and banks

be quartered in separate rooms with "negotiators" going back and forth in a modified collective bargaining format. Most of the teams brought fiscal and legal advisors.

The end product of almost three days of deliberations was an agreement to create a control board and to raise funds in three installments:

1. An interim loan fund of $125 million to meet immediate requirements, with the state, city and unions all raising a share of the total.

2. A multi-year program of $500 million raised by a new authority created by the legislature to re-establish credit for the schools.

3. "Bridge" funding of $225 million to carry the Chicago Board through the spring while the Illinois Supreme Court ruled on the constitutionality of the new control board -- a move designed to re-establish investor confidence.

Within two weeks a draft bill was prepared for submission to the Illinois General Assembly. The bill created a Chicago School Finance Authority with the power to borrow money for Chicago schools, approve the chief financial officers of the school system, and oversee the fiscal operation of the Chicago schools. Out of the Governor's meeting came an agreement to reduce the expenditure level of Chicago schools by $60 million in the 1979-80 school year and $160 million in 1980-81.

The legislature held "Committee of the Whole" sessions in January and passed the bill with two major additions:

1. the creation of a bipartisan legislative inquiry commission, including the State Auditor General, to investigate the need for additional measures; and

2. the dismissal of the entire Chicago Board of Education effective April 30, approximately ten weeks later. The Board President, John Carey, General Superintendent Joseph Hannon, and the two top financial officers of the Board had resigned previously.

The School Finance Authority was promptly appointed by the Governor and Mayor, each of whom nominated two members and agreed on a fifth person to chair the Board. All five members were either lawyers or business executives, three of whom lived in Chicago. Expenses for the authority were, by statute, deducted from the state aid payment already appropriated for Chicago schools. Payment of the notes would be made from dedicating .50% of the local school property taxes for the purpose until the notes were repaid. The Authority and the Chicago Board by early April agreed to appoint Joseph Mahran, a Communication Satellite executive who had been a New York City Financial advisor from 1975 to 1977, as chief Chicago school fiscal officer at a salary of $100,000 a year.

4. THE RESPONSE OF TEACHER UNIONS

Retrenchments and reductions in force are the worst problems teacher unions faced in the late 1970's and 1980's. City school fiscal crises not only jeopardized the size of the union and flow of membership dues but also threatened to reverse contract gains won in the 1960's and early 1970's. In each crisis the American Federation of Teachers at some point declared a strike over the shape and substance of the settlement. In New York it lasted a week, in Cleveland eleven weeks, and in Chicago ten days. However, the unions behaved very differently in the way they contributed to the short and long-term solutions.

The New York City United Federation of Teachers was a very powerful and politically effective union that had helped elect Governor Carey. The union controlled a four billion dollar pension investment fund for teachers. One of the first sources of possible cash for New York City were the several different municipal retirement system funds. Each of the key public employee union leaders after initial resistance but careful reflection agreed to:

1. Purchase hundreds of millions in MAC bonds and help build confidence in MAC and New York City; the teachers' share was 200 million dollars.

2. Accept new retirement money in the form of interest-bearing MAC notes, which for the teachers could have amounted to more than 50 million a year.

These decisions not only assisted in the early stages but potentially reduced the monthly new revenue totals required for operating the city. The city pension funds could operate. They were not bankrupt. Only the city that fed them was broke.

The Federation also had to agree to a number of unusual provisions that altered the existing contract. Several were called "give backs" (the opposite of "give-away") because the union agreed to give up:

1. the payment of extra funds to high school teachers for each hour (beyond a limit) they accepted duty substituting in a class for an absent colleague.

2. Cost-of-living increases for the next school year, which were to be deferred.

The teacher strike in September 1975 was over the interpretation of the contract. Union President Albert Shanker held that the salary deferral referred only to cost-of-living increases and not to annual step increases, which he contended were guaranteed. The Control Board did not agree and a court ruled quickly that the Control Board did in fact, through the power to reject contracts, possess the authority to delay or disapprove <u>any</u> increase in compensation.

The most drastic effect of the New York City crisis was, of course, the termination of 7,000 teacher positions. Although most dismissed staff were eventually offered a position, only 2,000 accepted re-employment.

The Cleveland teachers during the 1970's grew increasingly impatient with the practice of closing down the schools and cessation of payments. The teachers struck when their paychecks weren't available and subsequently to dramatize the need for salary increases and both more state and local aid.

Chicago teachers, led by Robert Healy, were concerned about the prospect of payless paydays and pressed very hard for the advances of state and city funds. Politically, the 25,000 teacher unions was hampered because they initially endorsed neither Governor Thompson, a Republican, nor Democratic Mayor Jane Bryne, who had ousted Michael Bilandic in a primary earlier in 1979. In fact, downstate teachers, many of whom had endorsed Thompson (he had Illinois Education Association/NEA Support), criticized his advancing state funds and insisted he do likewise for all school districts - a humane but very expensive move, which he understandably balked at doing more than twice.

Low point for the Chicago teachers was the lack of funds to provide a Christmas Eve payroll. However, Chicago teachers voted to continue teaching after the mid-winter vacation preferring back pay to no pay at all for no work. Healy and two aides attended the sessions in the Governor's mansion and publicly praised the January 5th settlement.

However, Healy denounced the provision for reducing the 1979-80 school budget once he discovered how angrily teachers felt about the dismissal of three thousand teachers. Although he tried to negotiate an acceptable compromise, with the Mayor and Board President, his union members would not support such a plan; union leaders then called a strike. They contended that teachers would unfairly bear the burden of staff reductions and that others, especially administrators and custodians, should be let go in equal proportions. Teachers reminded everyone of the large number of non-teaching employees - 22,000 (secretaries, cafeteria workers, maintenance staff, etc.). Healy bitterly lashed out against the bankers, the Governor and the Board of Education. A ten day teacher strike ended when the Mayor and Board agreed to cut 700 fewer teachers, make up nine of the ten days lost with pay, and substitute other cost reductions including the deferral of supply purchases.

Healy opposed vigorously the use of teacher pension funds as part of Phase One of the Governor's program. He asserted that the pension fund was underfunded and that it was illegal to invest teacher funds in a public school system. The Mayor meanwhile was pushing the policemen's fund for a major contribution. The teachers eventually bought more than a million dollars in Chicago school certificates with Healy purchasing a few himself as a goodwill gesture.

Chicago Board of Education officials and the Governor spoke of possible changes in class size provisions, reduction of fringes such as dental insurance, or deferrals of pay increases of 8% a year in each of two years. The

Chicago teacher leaders steadfastly refused, however, to reopen the contract. Healy much preferred to discuss which employee reductions, including teachers, would suffice in lieu of "give backs" or contract alterations.

5. THE TRANSFER OF POWER

Great cities or their schools do not face bankruptcy without profound repercussions. Financial institutions lend money only to organizations that avoid risks. Parents lose confidence in schools that do not open on time or whose teachers won't work in times of turbulence. Newspapers give city school budget crises front page coverage, causing genuine problems for Governors and legislators, who most of the time avoid treating education issues as "political".

Illinois downstate legislators grew so angry that many of them signed a petition on the theme "never again." Not satisfied with imposing a Receivership Board over the Chicago Board of Education, the legislature banished the incumbent board members - a rare slap at a major city governing board that included two labor union presidents, an Urban League president, veteran PTA Leaders and a vice-president of one of the largest banks.

How did the locus of responsibility shift? What changes in the pattern of decision-making emerged from these crises?

1. New York State governors and New York City mayors always compete for power, prestige and money. Although it helps when both executives are members of the same party, John Lindsay at times felt humiliated by Nelson Rockefeller and Abe Beame certainly felt reduced by Governor Hugh Carey. Beame fought the Control Board concept but lost, because both the state and federal government needed strong assurances that the city would not, could not default or overspend in the next few years.

   The authority to review city budgets, to approve major labor union contracts, to adjust the contribution of pension funds, to call for periodic audits of expenditures -- these were the major transfers of authority to the state. New York State only paid for 30% of the costs of education in 1975 and not much more than that in 1979. But the state accumulated substantial supervisory or veto power over the city.

   The New York Control Board hired staff to perform the difficult analyses of retrenchment and budget cuts. Visiting New York City in late December 1979 I learned that Control Board staff gradually were moving over to the agencies they reviewed to run them. For example, Frank Macchiarola the Chancellor of the New York City Schools and Richard Halvorsen his Deputy both were Control Board employees several years earlier.

   Much has been said about MAC as an innovation in the refinancing of city agencies. But the MAC concept doesn't work without the less glamorous Control Board oversight of expenditures and budgets. The New York City Control Board effectively placed state receivers over the city government and all major financial transactions.

Previously the New York City Board of Education could bargain with school employees, and, subject to funds made available by the Mayor and Board of Estimates a contract could be signed. Now a predominantly state agency or board can review, veto and force alteration in the contract. The city schools, already dependent on city officials, are now governed in large part by the state. Federal officials would not agree to their third party assistance until the existence of the Control Board was guaranteed through the 1980's. Since that board will exist from 1975 through at least 1985 the word "emergency" was stricken in the 1978 amendments to the original statute.

State intervention was followed by drastic reductions in city school staff, facilities and services. It is worth noting that the only major exception came because of a Congressional mandate to serve handicapped children (P.L. 94-142). During 1979 the New York Board while still reducing other program costs had to hire 11,000 new staff, as teachers, counselors and aides for handicapped students.

Thus, discretion over major employment and staffing decisions for a while moved away from the city and in particular from the City Board of Education. Also, the state through the office of the Special Deputy Comptroller has extraordinary power to review and report on municipal expenditures.

2. In Cleveland the city once took care of school financial problems without help from the state or federal government.

   By 1979, the state took away the right of a local city board to threaten to or actually cancel school for a month or more. The state offered emergency advances but only if a city agreed to stringent measures of retrenchment and budget balancing.

   By that same year the federal court insisted on racial desegregation. The court ordered the state to assist in the development of the plan. By 1980 the Governor and legislature agreed to appropriations to assist with extra desegregation costs. The Cleveland Board on its own had not moved very far in the direction of desegregation without prodding.

3. The Chicago school board lost more than any other city education board:

   -their total membership, who were fired as of April 30th
   -their top three executives, who resigned
   -the right to make budget estimates, which was given to SCHOOFA
   -the right to select independently a school finance officer
   -the ability to borrow money, and
   -the final say over expenditure levels

The Board of Education lost decision-making authority on most money issues to a hybrid state-city board which could by law exist for the life of the bonds sold - some thirty-three years or until the year 2013. The School Finance Authority by statute could fade if Chicago school budgets balance out three years in a row, but like "sunspots" could come back in force if the budget lost its balance at any point.

In New York and Chicago the power of the banking community became evident. Investment houses in New York City insisted on a "guaranteed revenue stream" from the city sales tax to pay back the MAC bonds. Risk was therefore minimized. Chicago bankers and their law firms insisted on a dedicated share of the property tax levy as a condition of their raising $400 million in 1980 or 1981. In each case including Cleveland the city schools were expected to pay back with interest the funds raised for their short-term relief.

Other major beneficiaries of these troubles were the accounting and auditing professions. Hundreds of thousands of dollars went to auditors and related consultants.

The financial community is not a monolith but rather a network of many small country banks and a handful of large clearinghouse banks located in major cities. Ostensibly, analysts for the banks, investment firms and the several rating services check frequently on the financial health and management capacities of cities. Very little evidence exists to suggest that either the banks or the educational boards in these three cities had much warning or much in depth analysis. The exception is that in Chicago the Civic Federation, a private tax watchdog group, and the major accounting firm Arthur Anderson, had in fact leveled public warnings about unbalanced budgets and financial practices. However, on the whole the financial community was no more prepared for the city school crises than for the fall of the Penn Central, W.T. Grant and the Chrysler Corporation.

State governments presumably watch school districts quite closely. But city school bureaucracies for many decades have managed to hold off their country colleagues from really detailed supervision and reports. New York State maintains a small staff in New York City but not much of a fiscal review team except over the major federal programs that require such a review. The New York Board of Regents and State Education Agency played no visible role in 1975. After all it was the city that went bankrupt, pulling down the schools as part of the total ship. The state agency role was to insist on standards, including the need for more special education staff, but in the end they were called on mainly to waive other requirements.

Ohio officials for most of the 1970's left city boards to their own devices. In fact a Federal Judge denounced the Ohio Board of Education for ostrich-like behavior in ignoring the Cleveland racial desegregation questions. With a new state superintendent the Ohio Board played a strong role:

a. in advocating the creation of an education emergency advance fund
b. in providing technical assistance on city school budget-balancing and reductions
c. in prohibiting the local options of closing down schools for a period of weeks to save money
d. in offering planning help and dollars to achieve school desegregation.

The Illinois Board of Education, new in 1975, paid substantial attention to selected school issues in Chicago right from the beginning.

a. In 1976 the Board placed Chicago schools on probation for failure to file a racial desegregation plan.
b. In 1977 the Board and State Superintendent levied a 30 million penalty on Chicago schools for trying "to save money" by closing down schools for 16 days (the Ohio solution), a practice already outlawed in Illinois.
c. In 1978 and '79 the Board supported legislation to make sure that state funds raised on the basis of a poverty factor in the state school aid formula actually were spent on disadvantaged children.

The State Board repeatedly sought money for city school desegregation assistance, bilingual programs and education of gifted and handicapped students. However, it was not involved in any concerted effort to supervise the chronically-imbalanced Chicago school budget. Annual newspaper stories about budget gimmicks used to balance the school budget raised very little interest or concern. The Board in 1980 prepared a variety of legislative proposals to give early warnings to local and state offices of impending fiscal disasters in public schools. It noted that the Illinois Board's prerogatives and responsibilities would need to be clarified and strengthened to avert future calamities.

6. THE LESSONS OF CITY SCHOOL BANKRUPTCY

The very natural impulse of citizens is to try to figure out, "Who's to blame for this mess?" The Illinois legislative commission spent several months interviewing local and state officials, auditors and financial experts to try to locate the culprits. New York City officials in December, 1979 predicted accurately that such a quest is not very productive.

City school problems are more the result of systemic or structural defects than of the mismanagement or malfeasance of individuals. Chicago schools did not become bankrupt overnight, nor did the City of New York. The causes are various:

1. It is very difficult and unpopular to raise property taxes for city schools.

2. It is very painful to close down individual school buildings, especially in cities where custodial unions have substantial strength and often assist city political leaders with election campaigns.

3. It is very tempting to try to "finesse" a deficit by engaging in short term borrowing with tax exempt municipal bonds for just as long as the rating services and banks will allow.

Note that all three cities endured their trauma in the 1970's:

- before state limits on revenues or expenditures were imposed
- in urban states that relied on both sales and income taxes to pay for public services

- prior to any total city school desegregation plan finally imposed or agreed upon.

One bank analyst was willing to explain that the risk factor in loans to Chicago schools had increased sharply during the 1970's with media coverage of school desegregation controversies. Specifically, the state decision to place Chicago schools "on probation" was considered a first step towards the cut off of state funds essential to the schools. HEW's referral of the Chicago desegregation case to the Justice Department was seen as placing future federal funds in jeopardy. These events may trigger more careful scrutiny by banks and investors of the capacity of urban school systems to repay their notes. Desegregation was in fact listed as a risk factor by one of he board rating services in April 1980.

Banks are instruments of a capitalistic economy and by no means can afford to behave as charitable organizations. New York City officials pointed out what was subsequently to prevail in the Chicago situation: banks want to minimize risks and in the financing of public enterprises will call for a "guaranteed revenue stream to eliminate risks."

The principles of city school finance assistance were expressed on January 5, 1980, with perfect clarity by John Perkins, President of the Continental Illinois National Bank and Edwin H. Yeo, Chairman of the Assets and Liability Committee of the First National Bank of Chicago, and a former U.S. Treasury official during the New York City crisis.

"Public schools are paid for with public funds. Teachers cannot work without getting paid. People who supply the schools with milk, heat and services must be paid. People who invest their savings in obligations of the schools must be paid."

These principles were violated somewhat in New York City when the existing city notes were "recomposed", in effect extended rather than defaulted upon. Several Chicago payments to the City Public Building Commission were delayed, a move that caused a shudder to go through the Chicago financial community. The Governor's legal and budget advisors learned from many sources just how fragile the ratings of the city and the state were. The markets for municipal notes are national and not regional or local. Every week small 'country" banks get notices or phone calls promoting the purchase of tax exempt public notes, which generally fill out a diversified investment portfolio for an individual or pension fund or corporation. Most banks and most investors cannot distinguish between Chicago City notes and Chicago school notes. It is the same city and what investors rely upon is the yield and reputation and past performance. The default or near default of municipal notes brings on a revulsion in the market place, a general aversion to purchases of any paper from that city. It makes the state in which the city is located suspect as well, even though the state may have a budget surplus, a high credit rating, and outstanding fiscal management as did Illinois in 1979.

Governors are generally advised to proceed very cautiously in such crises, to spread the risks on as many bodies as possible, but most of all to establish practically fail-safe guarantees that future budgets will be balanced

and note-holders paid. This was the lesson learned by Governors Carey in New York and Thompson in Illinois. They were urged to push their big city mayors into solutions and structures more inhibiting than the mayors wanted but not to exclude the mayor from share in the responsibility. They were counseled to create new structures on top of existing city governance devices to impose fiscal discipline.

So now New York has a City Board of Education (five members chosen by Borough presidents, two appointed by the Mayor) and a State Board of Education. City budgets must be reviewed by a Financial Control Board of state and city officials. Borrowing is handled by the board of a Municipal Assistance Corporation. What was an emergency solution is now a long term remedy. New York City officials do not forsee New York City regaining independent access to financial markets until late in the 1980's, if then.

Chicago has a Board of Education and a School Finance Authority Board -- whose members are in part state, part city officials. SCHOOFA reviews the Chicago budget, checks on expected revenues and handles the borrowing. The SCHOOFA budget is, in turn, approved by the State Board of Education, which audits both the federal and state funds going to the city schools.

Legislatures have added to the thick growth of public boards so characteristic of American education. But the financial community cannot allow the underbrush to be cut out right away. Banks must make a profit. Noteholders expect a return on their investment. City boards of education have lost credibility and legitimacy for their failure to adjust costs to enrollment decline and insufficient revenue. In the process they have lost the confidence of the financial community and the authority to borrow money on their own tarnished names.

Banks played a major role in designing the acceptable solution, for they do have by law and tradition a community service obligation. Bankers and lawyers played a very major role in designing the new patchwork of governance to restore investor confidence and so reopen the possibility of city school borrowing.

The power of public employee unions during fiscal bankruptcy crises was severely challenged. It was thought that city boards in the 1970's would become captive to these strong unions, and to an extent this did happen. Class sizes were reduced, fringe benefits added. But when no more money can be found to meet payrolls, when the state changes the rules on how to balance budgets and stay open, when the cuts are mandated by a higher board, the unions must in fact participate in the retrenchment strategies.

Teacher leaders in each city called strikes because they felt they had to protest at least some of the cuts. Teacher unions lost heavily even after the strikes. In fact, the strikes may have been necessary to maintain support for union leadership, to dramatize the plight of newly unemployed academics, and to try to cut the losses. The "fiscal crisis" strikes are noteworthy for the size of the losses to employee groups - 14,000 fewer positions in New York City, 3,000 in Chicago with thousands more to be lost in 1980-81; 2,000 in Cleveland.

Teachers have a stake in the stability of pension funds which are multi-million dollar funds (multi-billion funds in New York State). "The teachers have become bankers," one New York City analyst commented. They are no longer insulated from the world of financial investments. The future health of public employee pension funds naturally depends on the continued health of the larger city. Teachers who sit on pension management boards do not behave as street radicals. They become committed very quickly to strategies for restoring fiscal stability.

Business leaders play a very important role in reestablishing the borrowing capacities as well as the balanced budgets. New York Governor Carey appointed to the Control Board prestigious businessman - top executives of Bell Telephone, American Airlines, and Colt Industries - men far removed from political pressures and so substantial as to restore investor confidence. Governor Thompson did likewise in Illinois appointing senior executives of Commonwealth Edison, Hyatt House Hotels, and a former financial vice president of the University of Chicago to SCHOOFA.

America, however regulated and modified the free enterprise system may be in 1980, remains a capitalistic and corporate nation. Business executives are expected to be tough, efficient, to balance budgets, cut costs where possible, repay investments, and especially to avoid institutional bankruptcy. Their membership on control boards makes up for the lack of "businesslike" behavior by city boards whose members try to be advocates for children or programs. Possibly business executive appointments reflect the need for the restoration of legitimacy to municipal spending and borrowing mechanisms discredited by the spectre of near bankruptcy.

How can educators better manage the retrenchment in large city school systems? Must it take the kind of dramatic, traumatic assault on the system such as has been described?

Perhaps it may, San Francisco Superintendent Robert Alioto in 1978 exploited the passage of Proposition 13 and the loss of local revenue as the opportunity to close down many half-empty school buildings.

Is size, itself an inhibiting factor? A private school business manager in 1977 told me Chicago school problems, including compliance with various new Federal mandates, were hopeless. "You are expecting this huge dinosaur to scramble out of the tar pit?" was his assessment of the prospects for solutions.

Smaller cities and school districts seem to be able to "manage" decline and retrenchment not easily or painlessly but at least more adequately than large cities. Usually their effectiveness depends in part on the willingness of a special school closings committee to publicly "survey" enrollments and their projections, the age, shape and capacities of buildings, proposed economies to be achieved by closings, timetables, and transfer options for teachers as well as students.

City-dweller commitment to neighborhoods often runs very strong. It is easy to say "close some schools" from on high, much tougher to do it in practice. Chicago Superintendent Joseph Hannon told me "I tried many times.

Then the Board would hold hearing and some Alderman would come in with 500 parents to protest the action and the proposal would be shelved." As recently as 1978 he targeted 25 schools buildings for closing. The Board approved more than half but very few were actually closed because of delays and last minute appeals.

In smaller cities the school custodian is viewed as a low status hired hand. In large cities the custodian-engineer is a feudal chieftain. In New York City he is also a private contractor who rises to a certain point through civil service ranks and then can bid for a lump sum contract. He may hire friends and relatives to help him maintain and clean the schools. He is an entrepreneur, a small businessman, an employer who has a stake in keeping the schools not only clean but open.

Other cities treat the school custodian at least as an important foreman or crew leader. Visiting a Cleveland school in 1968 I saw a sign "All visitors must report either to the principal or the chief custodian," an apt description of divided responsibilities. The custodian is more likely to reside in the immediate neighborhood than is the principal, a professional with degrees who may live in a suburb or a condominium. Custodians and engineers pay dues to a union that very rarely strikes but achieves "understandings" with key political leaders. (The Chicago union has no written contract but operates on the basis of a "handshake" commitment about pay and working conditions.) They may assist various candidates for lower office and play active roles in the ward party organizations. They cannot be ignored in disputes about when or whether to close down a building.

One useful contribution of Mayor Jane Byrne was the insistence that all city department heads with facilities participate in a review of the sixty or more school buildings identified as surplus. She told Chicago Board of Education officials and her own staff that she wanted to know what possible use could be made of each of the underutilized buildings, whether there was an alternative public use or not, and if a school were demolished what would be the possible uses of the land. Other agencies need space, for example for community health or adult centers. Schools help anchor a neighborhood, and the Mayor made the quality of neighborhoods and community life important themes in her successful mayoral campaign.

The survey she insisted on is more than good politics. It is good government and sensible public administration of resources such as office space/playgrounds, and heating plants. School buildings in established residential neighborhoods cannot lightly be discarded.

Perhaps the lessons of timely retrenchment include these cautions:

1. City school boards must work closely with city officials on a timetable for possible transfer of surplus school facilities to other agencies.

2. School boards must make sure that not only teachers and students but also the custodians, teacher aides, cafeteria workers and other employees know where they will be working when their current school is actually phased out.

Teachers themselves resent whole-scale cuts of teachers without a proportionate reduction in the number of school administrators, central office staff (who number in the thousands in large cities), and other "non-teaching" staff. They will strike over a disproportionate reduction of teachers or over the method of reductions - more so than on whether any staff reductions must be achieved.

What are the prospects of avoiding city school bankruptcies and avoiding the need for control boards and SCHOOFA'S? They are gloomy indeed:

1. The percentage of city dwellers who have children in public school has shrunk and will continue to do so in the 1980's, reducing the number of people upset by the prospects of bankruptcies. Total enrollment has plummeted thirty, forty percent or more in cities from Boston to San Francisco. The tax cap craze and adoption of revenue limitations will further reduce the options of raising taxes or securing revenue elsewhere.

2. States other than Ohio have not viewed kindly the prospect of state-level municipal or educational advance funds, in effect a public bank which could help out when private funds dry-up. Ohio is a state full of medium sized to large cities. Perhaps Pennsylvania, California and New York (where Yonkers and Buffalo also had fiscal difficulties in the 1970's and several state-wide public authorities also went to the brink) should follow the lead of Ohio. But there is little discussion of such a remedy.

This latter option, the Ohio Model, is the most constructive for several reasons:

1. It continues to fix responsibility in a single city education board rather than proliferate boards.

2. It does not require emergency infusions of private money to rescue a public body. (It is instructive to note that this is precisely the opposite from seeking public money for private purposes such as the 1980 bailout of the Chrysler Corporation by federal and state governments).

3. It promotes use of the state education agency for the twin purposes of providing technical assistance to develop economy measures and for enforcing the adoption of a plan to reduce spending and bring a budget into balance.

There are possible variations on this theme, as well as additional measures, such as those recommended by the Illinois State Board of Education to the Illinois General Assembly:

1. The speedup of state reimbursement programs, ultimately a switch to accelerated or current funding so as to reduce the borrowing needs of cities or city school systems.

2. A requirement for state approval of budgets when a city school system engages in borrowing beyond a certain percentage or when other indicators of fiscal weakness show up in annual audits.

3. The revision of school audit formats so that management practices such as inter-fund borrowing or the use of capital funds for operating expenses are forbidden or are more visibly displayed.

4. Granting the state the authority to conduct periodic local school audits and fiscal investigations, just as the federal government may do at any time.

5. A requirement to change audit firms periodically, such as every five years.

One alternative to state-level solutions is the creation of a national emergency loan bank to help cities and large school districts in times of financial distress. The federal treasury could provide moderate interest loans and would presumably require not only repayment but approval in advance of a remedial program, including a plan for more adequate state and local finance.

Inviting more federal involvement could serve to promote the possibility of federal control. However, to a dramatic extent federal statutes on the handicapped, the disadvantaged, racial and linguistic minorities have already burdened the cities and required heavier spending. Not every city would need to or want this help. The federal government already provides a variety of banking services such as the secondary market for housing programs and college loan programs, campus or state-level. The desirability of the remedy along with necessary safeguards for curtailing the zeal of budget-cutters should be more rigorously debated in the months ahead.

SUMMARY

One purpose of this paper was to show that city school bankruptcies look more alike than different. Newspaper headlines and swiftly prepared wire service reports blur the "school crises" together. The schools are declared broke, the teachers denounce officials and go on strike, and then the big political and money men come in with elaborate solutions. No one is sure who wins or who loses except those neighborhoods which subsequently find their nearest school facility about to be closed.

The genuine difference is in the response of public officials. Governments and organized city teachers these days know where the money is, for example: in cash reserves or in public employee pension funds. One or another group may not wish to use these public sources. The alternative is private financing such as obtained by tax anticipation notes or bonds with a "guaranteed stream" of revenue to satisfy those buyers whose confidence otherwise has been shaken by adverse publicity.

The simple analysis is that which says "the city schools went into the red because the leaders couldn't make the tough retrenchment decisions". To an extent this has characterized many of the larger city school systems, some of whom have survived while others lost substantial autonomy to control boards.

The complex question is how will public officials plan for future city school financial debacles? As Newton Minow, Chicago Counsel to one of the large banks and a former federal official, kept asking, in January 1980, "Why are private institutions being asked to solve the problems of a public tax-supported institution?" It is the reverse side of the question asked by state or federal legislators while debating the bailout requests of private corporations. Do we want our city schools privately mortgaged along with our homes or sustained essentially by tax dollars? Who then will supervise and control our urban school systems and for whose interests will they be managed? The New York and Chicago situations provoked governors of different parties each to call in the banks and investment houses for relief. Smaller cities may find enough relief at the state level. States with large cities should plan for emergencies and contingencies even now. The alternative would be a temptation to ask the federal government to stand by to bailout every city, state or school system in need. The states need early warning systems while the schools themselves need a greater share of state-level funds to makeup for the dwindling property tax base and the transiency of so many city dwellers. Tax exempt bonds and notes may be useful emergency solutions but are hardly the proper base on what to build the educational systems for a nation of great cities.

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